

Report on the Preparation of the LDC Graduation Transition Strategy of Nepal

(LDC Monitoring Report)



Government of Nepal

National Planning Commission

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1. Introduction

1.1. Structure of the Economy

Nepal, being a landlocked and low-income country in South Asia, has witnessed a rapid change in its production structure. In the past, the agriculture sector used to have a high share in the overall GDP. However, in recent years the economy has observed a sharp rise in the share of services sector in GDP. The share of agriculture in GDP has declined from 32.00 percent in FY 2012/13 to 24.6 percent in FY 2022/23 and the proportion of population depending on the agriculture also declined to about 50 percent in 2022 from 64 percent in 2011.

The share of industry sector has declined slightly from 14.5 percent in FY 2012/13 to 12.9 percent in FY 2022/23 indicating low growth in this sector. The share of services sector has increased to 62.4 percent in 2022/23 from 53.5 percent in 2012/13. Within the services sector, the share of education sector has shown a positive structural change largely due to rapid expansion in the access to education services. In the health sector, despite notable progress in the health services as indicated by steady rise in average life expectancy, among others and in the aftermath of COVID -19 more priority to the health sector has been given, its contribution to GDP remains 1.9 percent in 2022/23 comparing to 1.3 percent in 2012/13. Moreover, the share of public administrative services, finance and insurance activities has also been increased in the last one decade. However, the share of construction and transport sector either stagnated or declined during the same period. The structural shift in the economy has contributed very little to raise the productive capacity and productivity of the economy.

The trade sector share in GDP remained around 15 percent. In total trade, share of imports is in increasing trend and the share of exports is declining in recent years. Total foreign trade of goods and services to GDP remained 43.7 percent in FY 2022/23, with export 7.2 percent and import 36.5 percent. The ratio was 41.9 percent in FY 2012/13 with export 9.3 percent and import 32.6 percent. Thus, the trade gap is widening annually.

1.2. Macroeconomic Trends and Social Sector Development

The COVID-19 pandemic severely impacted economic growth rate causing a 2.42 per cent negative growth in GDP in FY 2019/20. However, in recent years a positive trend has been witnessed. Annual GDP increased by 4.84 percent in FY 2020/21, 5.61 percent in 2021/22, and 1.86 percent in 2022/23. The GDP growth rate averaged 4.1 per cent during the last three FYs.

A rise in capital spending, particularly for public health and welfare in the face of the coronavirus, led to a budget deficit in Nepal of 5.3 per cent of GDP in 2020. (Table 1)

Per capita income exhibited steady growth, rising from USD 1,284 in FY 2020/21 to USD 1,410 in FY 2022/23, suggesting improved individual economic well-being and potential for increased domestic consumption. Nepal has been able to reduce poverty significantly to 15.3% of the population below the national poverty line and a multidimensional poverty index at 17.4%.

During the COVID-19 pandemic, remittances continued to arrive at recipient families, providing buffers against income losses. ODA as the proportion of GNI has not increase as expected and tourism sector would not return to pre-pandemic levels by 2023. Access to water and sanitation has improved over time.

Table 1: Selected Macroeconomic Indicators of Nepal, 2020/21- 2022/23

Indicators	2020/21	2021/22	2022/23
GDP growth rate at constant price (%)	4.84	5.61	1.86
GDP at current price (NPR in billion)	4353	4934	5381
GDP at current price (USD in billion)	36.92	40.84	41.20
Per Capita GNI (in USD)	1284	1407	1410
Gross Domestic Savings as a per cent of GDP	6.4	5.8	6.4
Gross National Savings as a per cent of GDP	31.5	29.0	31.7
Inflation Rate (%)	3.6	6.32	7.71
Revenue Growth (%)	16.0	14.1	-9.3
Revenue as a per cent of GDP	22.4	22.6	18.8
Government expenditure Growth (%)	9.7	9.5	9.1
Government expenditure as a per cent of GDP	27.5	26.6	26.6
Domestic Debt as a per cent of GDP	18.4	20.0	20.9
External Debt as a per cent of GDP	21.5	20.8	20.3
Remittances as a per cent of GDP	22.1	20.4	22.9
Exports of goods and services as a per cent of GDP	5.1	6.8	7.2
Imports of goods and services as a per cent of GDP	37.9	42.6	36.5
Balance of Payments (USD in billion)	1.23	-255.26	290.52
Direct investment (NPR in billion)	19.51	18.56	5.96

Indicators	2020/21	2021/22	2022/23
Foreign Exchange Reserves (USD in billion, mid- July)	11.75	9.54	11.74
Foreign Exchange Reserves (months of imports of goods and services) mid- July	10.17	6.94	10
Exchange Rate (USD-NPR, mid-of-July)	119.04	127.51	131.17

Source: National Accounts Statistics of Nepal (2022/23), National Statistics Office; Economic Survey 2021/22, Ministry of Finance, Government of Nepal; Nepal Rastra Bank's Annual reports (2020 to 2022/23)

The maternal mortality ratio (MMR) in 2021 reduced at 151 maternal deaths per 100,000 live births which was 239 in 2016. This decline in the MMR reflects the improvement in maternal healthcare services, access to skilled birth attendants, and promoting safe delivery practices. Similarly, the youth literacy rate for aged 15-24 years in 2022, which stands at a 90.8%, indicates a satisfactory situation in education among the younger population. However, the overall literacy rate for individuals aged 15 years and above remains relatively low at 60.5%. This big discrepancy in literacy rates highlights the urgent need to address this issue of literacy across all age groups. Moreover, there is also challenges in attaining universal access to quality education, as the mean years of schooling in Nepal currently stands at 5.1 years.

Nepal's Human Development Index (HDI) has shown remarkable improvement, with the latest a value of 0.602. Additionally, the inequality adjusted HDI, which takes into account disparities in development outcomes, reveals a value of 0.449 for Nepal. Furthermore, Nepal has made notable progress in healthcare and living standards, as reflected by the increased life expectancy at birth, which reached 71.2 years in 2022. Gender Inequality Index (GII) for Nepal in 2021 is 0.452.

1.3. Major Prospects for Development

Nepal is still agriculture dependent economy. However, due to its richness in water resources and natural and cultural heritages, there exist high potentials of reaping the benefits from its natural resources. Some of prospects for developments can be listed as follows;

i. Development of Hydropower

Nepal has potential of generating 42,000 MW economically viable hydroelectricity. However, a total generation capacity in the FY 2022/23 reached only 3001 MW with the commissioning of new projects equivalent to the capacity of 491 MW. In recent

month, the long-term power export to India created a conducive environment for the hydropower development in the country along with the possibility of expanding power market. Nepal entered into the era of power surplus during the wet season months. At present, a total of around 452 MW of hydropower is being exported to India.

ii. Development of tourism sector

The tourism sector has a high potential for the development of the Nepali economy. This sector enjoys comparative advantages because of its unique natural and cultural heritage and diversity. In particular, natural beauty in the mountains, important religious destinations, and unique cultural and archaeological heritages are high-potential treasures for tourism in Nepal. Proximity to rapidly developing neighbors – India and China, natural beauty, great feeling of peace, amiability, spirituality, birthplace of ancient knowledge and philosophy, bio-diversity, - all these factors have created the possibility of Nepal being a tourism hub.

iii. Use of Forest Resources

There is a high potential for domestic value addition in the use of botanical resources and herbs available in Nepal based on their comparative advantages. Nepal is a rich country in terms of biodiversity.

iv. Development of hub of the health and education

There is a prospect available to creating a favorable environment for making Nepal a hub for higher education in various subjects through the development of research-based education. Similarly, Nepal can also be developed as a hub for health services by increasing investment in health sector, increasing availability of new information technology, making health service systematic and of high quality.

v. Development of ICT sector

Expanding use of ICT in the overall development, increasing investment, a gradual increase in digital literacy, development of new technologies, and increasing use of information technology in the mass communication sector has increased prospect for development of ICT sector for development.

vi. Demographic Dividend

Nepal's demographic structure shows that young population under the age of 18 is approximately 40 per cent. Similarly, the share of 15–34 years age group in total population is more than 45 percent. These indicate demographic window of opportunity.

1.4. Major Problems and Challenges in Development

i. Low Productive Capacity:

The structural problems including poor market linkages is still constraining the prospects of enhancing productive capacity, augmenting productivity in most promising sectors and raising consumption, investment and export demand. The structural weaknesses in enhancing entrepreneurial and technological capability and strengthening institutional capacity have been the parts of the problems in mobilizing and investing in most productive sectors with high returns and outcomes.

ii. Poor Infrastructure:

Poor transport infrastructure, problem of connectivity, limited practices to follow the value chain approach in production, distribution and exchange are inhibiting the problem of expanding markets with less encouraging environment toward commercializing of agriculture at a faster pace.

iii. Low Human Resource Development

Nepal lags far behind in high quality human resources development. The task of utilizing demographic dividends by increasing opportunities for productive employment through the development of skilled human resources and healthy and educated citizens are challenging.

iv. High Youth Unemployment Rate

With low level of human resource development together with structural impediments in many potential areas, the labor market has serious problems from both supply and demand side of the economy. The labor force participation rate remains low, approximately 38.5 percent. Similarly, out of the total labor force, 11.4 percent is unemployed. Within this, youth unemployment rate is very high at 69 percent. Among the employed, 23.4 percent are self-employed and 13.5 percent are unpaid family workers. Nearly 40 percent of extended labor force in Nepal remains underutilized.

v. Low and Fluctuating Economic Growth and High Poverty

The task of achieving equitable economic prosperity and qualitative improvement in citizens' lives is full of challenges. For this, it is necessary to ensure rapid economic growth by building modern infrastructures and quality human capital. A significant amount of resources is required to end the absolute and multidimensional poverty and to substantially reduce income inequality. Enhancing production and productivity through commercialization of agriculture and forest products, expansion of the industrial sector, and increasing the quality of the service sector are equally challenging.

2. Current Status on LDC Graduation

LDC graduation represents important development milestone and it indicates country progressing on its overall economic aspects. Nepal will graduate to a developing country status by November 2026. Nepal was eligible for graduation at the 2018 triennial review as it had fulfilled two of the three graduation criteria, viz., Human Assets Index (HAI) criteria and Economic and Environmental Vulnerability Index (EVI) criteria for the two consecutive triennial reviews in 2015 and 2018. However, due to the adverse effects of the devastating earthquake, low GNI per capita than the threshold level and other vulnerabilities, in 2018 Nepal government requested the CDP to postpone the graduation process. The latest triennial review in 2021 again showed that despite GNI per capita being still low at \$1027 against the revised threshold of \$1222, Nepal qualifies for the graduation. The review shows that there is further improvement in both HAI and EVI compared to 2018 with index values at 74.9 and 24.7 respectively. In view of continued adverse impact of COVID-19 on the economy in general and risks of enduring vulnerabilities for many years in particular, Nepal government requested the CDP to extend the transition period from three to five years. Based on the CDP recommendations and endorsement by the ECOSOC, the UN General Assembly has given concurrence for Nepal's graduation with transition period of 5 years. Nepal is, thus, poised to graduate from the Least Developed Country (LDC) group in 2026. The eligibility entails Nepal's significant achievements in socio-economic development fronts.

Table 2: Nepal's Performance in the CDP Triennial Reviews for LDC Graduation

Criteria	Graduation Threshold	Nepal's Performance		
		2015	2018	2021
GNI per capita	≥ USD 1242 (2015) ≥ USD 1230 (2018)	USD 659	USD 745	USD 1027

	\geq USD 1222 (2021)			
Human Assets Index (HAI)	≥ 66	68.7	71.2	74.9
Economic and Environmental Vulnerability Index (EVI)	≤ 32	26.8	28.4	24.7

3. Impact of LDC Graduation

After LDC graduation, Nepal will go one step further on development milestone. However, this will bring both opportunities and challenges in the development process. Opportunities associated with graduation demand solid preparedness of the country for the graduation whereas challenges come with the implications associated with changes in international support measures.

LDC graduation will bring challenges for Nepal as certain international support measures (ISM) such as preferential market access, concessional official development assistance, and other general support that the country enjoys at the moment will be phased out.

3.1. Impact on Trade

The primary trade related loss will result from the loss of preferential market access for goods and reduced flexibilities in implementing WTO provisions. The graduation, and the subsequent loss of preference in the major export destinations will have sizeable impact on Nepal's overall exports including the exports to the European Union (EU). Not accounting for the impact of change in Rules of Origin (ROO), a study conducted by WTO and EIF in 2020 using a partial equilibrium model based on the export structure of 2016-2018 estimates that graduation will reduce Nepal's exports to the EU by around USD 20.6 million, equivalent to almost 20 percent of Nepal's exports to EU. The change in tariff rates with certain variations among countries will have impact on Nepal's exports to another destination as well. The impact is expected to be significant for the export of clothing and textiles whereas other exportable items will also be adversely affected. Besides the change in tariff rates, LDC graduation also affects market access in the form of more stringent rules of origin. While detailed studies into the impact of change in ROO on Nepal's exports are lacking, preliminary evidence suggests that some sectors may be adversely affected by the increased stringency of ROO. For instance, many exporters of clothing products, who currently export to the preference-granting countries by fulfilling the single transformation criterion may not be able to fulfill the double transformation criterion. Regarding services trade, the impact of graduation is expected to be insignificant,

particularly because the modalities for granting preference to service suppliers from the LDCs are not well established.

3.2. Impact on Foreign Assistance

Because of the government commitment to fulfill the SDGs by 2030 and high development needs, the country needs foreign assistance as the domestic resource mobilization is not adequate to fulfill the required financial resources. Therefore, to reduce the financial resource gaps the official development assistance (ODA) still occupies a good share in the total government budget. The share of ODA to GDP has remained constant around 5 to 6 percent in the last decade and it constitutes, on an average, about 23 percent of the budget expenditure and almost 60 percent of the total development expenditure. The LDC graduation does not directly affect the level of ODA as development partners generally do not consider LDC status to be a key determinant of ODA support. However, the impact of LDC graduation may be witnessed in the form of increased cost of loans disbursed by the development partners. As the LDC graduation implies rising trends in per capita income, the graduation is often accompanied by a shift in World Bank's income category to lower middle-income from low-income, which has been the case for Nepal. This leads to the drying up of sources of concessional finance, thus increasing borrowing costs in the form of higher interest and shorter repayment period. Furthermore, another impact of LDC graduation on development cooperation for Nepal will be the loss of access to funding that is specifically allocated for LDCs. These include support provided by Enhanced Integrated Framework (EIF) (trade capacity related support), Least Developed Countries Fund (climate change related support under United Nations Framework Convention on Climate Change), the UN Technology Bank for Least Developed Countries (support to enhance the contribution of science, technology, and innovation), the Investment Support Programme for LDCs (support towards investment-related negotiations and dispute settlement), and the United Nations Capital Development Fund (UNCDF) among others.

3.3. Other Impacts

Likewise, technical cooperation and delivery mechanisms might undergo some changes, especially regarding the multilateral organizations including the UN system such as the organizations like UNDP and UNICEF which have given more priority to the LDCs, allocating about 60 percent of their budget to LDCs.

3.4. Opportunities from Graduation

Graduation to the developing country status is expected to build confidence on foreign investors in bringing foreign direct investment (FDI) into the country. Local investors are expected to be highly motivated toward establishing and upgrading businesses and enterprises as the business climate is expected to be improved thru governance reform induced by graduation momentum. Therefore, it will likely improve the domestic as well as foreign investment.

4. Nepal's Preparation towards LDC Graduation

As a focal agency in preparation of the LDC graduation strategy a **High-level Steering Committee** has been formed under the chairmanship of the Honorable Vice-Chair of NPC at the federal level. The Committee has decided to prepare LDC graduation strategy and the National Planning Commission (NPC) has been preparing a Smooth Transition Strategy for easing the graduation process and the consequent phasing out of international support measures.

In the process of preparing Graduation Strategy, the National Planning Commission (NPC) has been in consultation within the Commission and with other relevant stakeholders including provincial government representatives, development partners, private sector associations for preparing and finalizing the LDC graduation strategy. Nepal has also been in a regular communication with Multilateral agencies including WTO, World Bank and UN agencies including CDP as a part of preparation for the LDC graduation. Nepal has been collaborating with other LDCs in Graduation agenda including its co-graduating countries (i.e., Bangladesh and Lao PDR) to share learning and experiences from each other.

4.1. LDC Smooth Transition Strategy

In the leadership of National Planning Commission, Nepal is finalizing the smooth transition strategy of LDC graduation to facilitate Nepal for smooth transition, to ensure quality graduation in the context of prevailing internal and external challenges, and to ensure sustainability of the graduation beyond 2026 for a long horizon. The strategy will focus on six major areas including macroeconomic stability and financial sustainability, trade and investment, economic transformation, building productive capacity, climate change and disaster risk management, and social inclusion and integration. The strategy seeks to bring

together entire federal, provincial and local governments of Nepal, multi-lateral and bilateral development partners, private sector, civil society, cooperatives and south- south partners in tackling most pressing challenges Nepal will face due to LDC graduation. It will be harmonized with the Sixteenth Five-year National Development Plan and second provincial development plans 2024/25-2028/29 which will warrant coordinated effort of the three tiers of government toward smooth transitioning of Nepal to a developing country and continuity of reform beyond graduation. Implementation of the strategy will be ensured through formulation of different committees/mechanisms with representation from different federal, provincial and local governments. Detail sectoral strategies will also be prepared by the respective ministries to mitigate the impact of graduation and avail the opportunities created by graduation. Currently, the draft of Smooth Transition Strategy (STS) is in the process of wider stakeholder consultation. It is expected to be adopted by the government by the early 2024.

4.2. Sixteenth National Development Plan

The Government of Nepal is currently formulating the Sixteenth National Development Plan for the five years period and it will be implemented from fiscal year 2024/25 to 2028/29. With the long-term vision of "**Good Governance, Social Justice and Prosperity**" the Plan will focus on key strategies and interventions on economic, social, environmental dimensions including strategies to achieve sustainable development goals, manage LDC graduation. The overarching goal of the Plan will be to achieve good governance, social justice and prosperity through structural transformation by identifying, addressing and solving the structural obstacles seen in development efforts. In that respect, the Plan seeks to sustain and improve the achievements in the areas such as per capita national income, life expectancy at birth, poverty reduction, social empowerment, road infrastructure and access to drinking water and sanitation and interconnection of communication networks among others. Likewise, the upcoming Plan will emphasize on tackling certain structural, economic, social and environmental challenges that will ensure sustainability of the graduation. The plan will complement the LDC Smooth Transition Strategy to ensure its alignment in plan and programs of various government entities including provincial and local governments.

4.3. Nepal Trade Integration Strategy (NTIS) 2023

The Government of Nepal has recently launched Nepal Trade Integration Strategy, 2023 which is being implemented for five years starting from 2023 to 2028 AD. The strategy aims to increase the country's trade-to-GDP ratio to 55% by 2026 from 43.81% in 2021. It also targets

to increase share of goods and services exports to GDP to 20% from 6.3% in the base year 2021/22. Promulgated in the context of LDC graduation, implementation of the strategy plays vital role in mitigating impact of graduation by focusing on building trade enabling environment, developing exportable products, diversifying products and markets, building trade infrastructure, facilitating, and improving business climate through governance reform among others. NTIS 2023, has specifically identified possible implication of LDC graduation for Nepal's international trade and has identified the measures to tackle these problems and challenges. In particular, these measures are related to accessing the GSP and GSP plus facility from EU, Turkey and United Kingdom; continuing partnership with other least developed countries in the regional and multilateral forum to ensures sustainable graduation; examining possible scope for bilateral trade agreements with other major trading partner countries. NTIS, 2023, being a comprehensive strategy covering broad scope of trade governance will also contribute significantly towards achieving sustainable development goals by increasing domestic production and productivity, promoting exports, reducing trade deficits and creating jobs.

4.4. Proposed Institutional Set up

At present, the Government of Nepal has set up a robust institutional mechanism to ensure a smooth, sustainable, meaningful and irreversible graduation. The National Planning Commission (NPC) works as the focal organization for coordination of all activities regarding LDC Graduation of the country. The drafted Smooth Transition Strategy has also envisaged the formation of new committees and restructuring of the existing one at federal, provincial and municipality-levels for the effective implementation of LDC Graduation.

A **High-level Coordination Committee** has been proposed to be formed under the chairmanship of the Rt. Honorable Prime Minister at the federal level. The Members would include the Hon. Minister of Finance, Hon. Minister of Foreign Affairs, Hon. Minister of Industry, Commerce, and Supplies, Hon. Chief Ministers of the Provinces, Hon. Vice-Chair of NPC, and the Chief Secretary would function as the Member-Secretary. The existing **Steering Committee** has been proposed to be restructured with the Hon. Vice-Chair of NPC chairing the committee. A **Monitoring and Evaluation Committee** is also envisioned to be formed at the federal level to coordinate with relevant ministers and agencies and prepare regular progress reports. The Secretary looking after the governance division at the Office of the Prime Minister and Council of Ministers would chair the committee.

A Province-level **Implementation Committee** is proposed to be formed in all seven provinces of the country. This committee will have an overarching role of LDC graduation and STS implementation at the provincial level. The committee is envisioned to be formed with the Hon. Chief Ministers as the Chair. A **Municipality-level Implementation Committee** is proposed to be formed in all municipalities. The committee would be formed with the Mayor/Chairperson as the Chair of the committee.

5. Conclusion

Nepal will graduate to a developing country status by November 2026. Toward that end, harnessing the positive implication and mitigating the adverse impact of graduation is key to ensure smooth, irreversible and sustainable graduation from its LDC status. The graduation agenda is well taken up in sectoral policies including in the trade integration strategy and the forthcoming Sixteenth National Development Plan of Nepal. Furthermore, Nepal is preparing LDC Graduation Smooth Transition Strategy which will be a milestone document to guide the overall process of graduation.